Fibonacci and the AUD/USD – To hedge or not to hedge?

I am often asked the question about what to do when considering offshore investments and the level of the Australian Dollar. It is a tricky question as we know that there are many influences that help determine the level of the AUD with the most popular being the level of interest rates globally and the prices of the major commodities that make up the bulk of Australia’s exports.

I see another volatile period ahead as Australian interest rates adjust to the low yield environment and the US interest rates continuing to have an upward bias although moderated by the recent comments by Federal Reserve (Fed) Chief, Janet Yellen, around the risks to global growth underscoring a greater awareness of the Fed’s influences and vulnerability to events outside the US (Australian Financial Review 18th March 2016, Companies & Markets, page 13).

I am mildly optimistic about a strengthening AUD from the lows seen in January this year (0.6867 on the 20th Jan 2016). The Reserve Bank of Australia has kept Australian cash rate targets at 2% and is prepared to ease them further if necessary to stem the strength of the AUD given our reliance on export revenue.

To gain a better insight into the market direction I thought it would be good to take a look at where the AUD/USD has been over the last 15 years and consider what are some important support and resistance levels to target for either hedging client’s international holdings or remaining unhedged. From the analysis of the data:

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Years | Records | Min | Date | Max | Date |
| 1 | 252 | **0.6867** | **20/01/2016** | 0.8122 | 14/05/2015 |
| 2 | 502 | 0.6867 | 20/01/2016 | 0.9458 | 2/07/2014 |
| 3 | 752 | 0.6867 | 20/01/2016 | 1.0553 | 12/04/2013 |
| 5 | 1256 | 0.6867 | 20/01/2016 | **1.1055** | **28/07/2011** |
| 7 | 1758 | 0.6326 | 2/03/2009 | 1.1055 | 28/07/2011 |
| 10 | 2511 | 0.6122 | 28/10/2008 | 1.1055 | 28/07/2011 |
| 15 | 3784 | 0.4833 | 3/04/2001 | 1.1055 | 28/07/2011 |

Source Data: RBA

So from the data the following is revealed:

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| Years | Range | 0.382 | 0.5 | 0.618 | 0.382 | 0.5 | 0.618 |
| 1 | 0.1255 | 0.0479 | 0.0628 | 0.0776 | 0.7346 | 0.7495 | **0.7643** |
| 2 | 0.2591 | 0.0990 | 0.1296 | 0.1601 | **0.7857** | 0.8163 | **0.8468** |
| 3 | 0.3686 | 0.1408 | 0.1843 | 0.2278 | **0.8275** | 0.8710 | **0.9145** |
| 5 | 0.4188 | 0.1600 | 0.2094 | 0.2588 | **0.8467** | 0.8961 | 0.9455 |
| 7 | 0.4729 | 0.1806 | 0.2365 | 0.2923 | 0.8132 | 0.8691 | 0.9249 |
| 10 | 0.4933 | 0.1884 | 0.2467 | 0.3049 | 0.8006 | 0.8589 | 0.9171 |
| 15 | 0.6222 | 0.2377 | 0.3111 | 0.3845 | 0.7210 | 0.7944 | 0.8678 |

Source: FOX Asset Management

What this data tells me is that if we assume that the recent bottom holds at 0.6867, the bounce should have been limited to 0.7650 however, with a break of that level now evident, the run up can potentially see a test of the 2 year traded range (61.8% Fibonacci) level of **0.8450**. Obviously there will some resistance on the way up at the 0.7850 and 0.8275 is expected. If 0.8450 is breached then, 0.9150 may be the objective.

The recent sell-off down to the 0.6867 area may also be retested down the track with potentially the 7-year low of **0.6550** area the objective if breached. A breach of that support could see the market test the 10 year (2008) level of 0.6100.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Years | Min | Date | Max | Date | Perf % |
| 1 | 0.6867 | 20/01/2016 | 0.8122 | 14/05/2015 | -15.5% |
| 2 | 0.7604 | 11/03/2015 | 0.9458 | 2/07/2014 | -19.6% |
| 3 | 0.8716 | 24/01/2014 | 1.0553 | 12/04/2013 | -17.4% |
| 4 | 0.9675 | 4/06/2012 | 1.0608 | 19/03/2012 | -8.8% |
| 5 | 0.9500 | 4/10/2011 | **1.1055** | **28/07/2011** | -14.1% |
| 6 | 0.8156 | 7/06/2010 | 1.0186 | 4/02/2011 | -19.9% |
| 7 | 0.6564 | 16/03/2009 | 0.9349 | 16/11/2009 | -29.8% |
| 10 | 0.6122 | 28/10/2008 | 1.1055 | 40752 | -44.6% |
| 15 | **0.4833** | **3/04/2001** | 1.1055 | 28/07/2011 | -56.3% |

Source: FOX Asset Management

Whilst not an exact science it does give me a better perspective on where the AUD/USD range will encounter some headwinds or support. I expect the AUD/USD will trade within the **0.6550** to **0.8450** range unless something significant happens on the interest rate or commodity price front to upset the apple cart..

A 10% market move for this year from here **0.7680 (noon 18th March 2016)** would be 768 pips or **0.8448** on the topside and **0.6912** on the base. A **15% market move would see 0.8832 or 0.6528**. I am in the 0.8450 camp for this run up but always wary of the Reserve Bank of Australia (RBA) ability to stem the rise by pushing the target cash interest rate lower or potentially direct intervention.

From a hedging perspective, if you believe that commodity prices will continue on the recent uptick then hedged to 0.8450 level makes sense. If you believe that this is just a dead cat bounce for commodities and that China will slow further then, this is not a bad level to go unhedged when buying offshore assets.

In answer to the hedge or not to hedge question, I tend to fence sit and **hedge 50% of the offshore exposure domestically to take the currency influence out of the equation** and focus on the performance of the underlying assets for clients.

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